FROM THE DESK OF

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RRB Financial Reports

The Railroad Retirement Board is required by law to submit annual reports to Congress on the financial condition of the railroad retirement system and the railroad unemployment insurance system. These reports must also include recommendations for any financing changes which may be advisable in order to ensure the solvency of the systems. In June, the Board submitted its 2002 reports on the railroad retirement and unemployment insurance systems.

The following questions and answers summarize the findings of these reports.

1. How much money was in the railroad retirement and railroad unemployment insurance trust funds last year?

By the end of fiscal year 2001, the net position of the railroad retirement trust funds was $19.8 billion, while the railroad unemployment insurance accounts balance was $40.1 million.

2. Did the 2002 report on the financial condition of the railroad retirement system reflect any benefit or financing changes?

The report reflects changes in benefit and financing provisions required by the Railroad Retirement and Survivors' Improvement Act of 2001. The benefit changes contained in the new law liberalized early retirement benefits for 30-year employees, eliminated a cap on monthly retirement and disability benefits, lowered the minimum service requirement from 10 years to 5 years of service if performed after 1995, and provided increased benefits for some widow(er)s.

The financing sections of the new law provided for the investment of railroad retirement funds in non-governmental assets, adjustments in the payroll tax rates paid by employers and employees, and a repeal of the supplemental annuity work-hour tax on employers.

Beginning with calendar year 2004, tier II taxes on employers and employees will be based on a 10-year average of the ratio of certain asset balances to the sum of benefits and administrative expenses (the average account benefits ratio). Depending on this ratio, the tier II tax rate for employers will range between 8.20 percent and 22.10 percent, while the tier II tax rate for employees will be between 0 percent and 4.90 percent.

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3. What was the overall finding of the 2002 report on the financial condition of the railroad retirement system?

The 2002 report, which addressed railroad retirement financing during the next 25 years, was generally favorable, concluding that, barring a sudden, unanticipated, large decrease in railroad employment or substantial investment losses, the railroad retirement system will experience no cash-flow problems for at least 19 years. However, the 2002 report also indicated that the long-term stability of the system is still questionable. Under its current financing structure, actual levels of railroad employment and investment returns over the coming years will largely determine whether corrective action is necessary.

4. What methods were used in forecasting the financial condition of the railroad retirement system?

The 2002 report projected the various components of income and outgo of the railroad retirement system under three employment assumptions, utilizing different patterns of changes and decreases in the railroad work force for the 25 calendar years 2002-2026. The projections of these components were combined and the investment income calculated to produce the projected balances in the railroad retirement accounts at the end of each projection year.

Projecting income and outgo under optimistic, moderate and pessimistic employment assumptions, the 2002 report indicated no cash-flow problems occur throughout the 25-year projection period under the optimistic and moderate assumptions. Under the pessimistic assumption, however, cash-flow problems occur in 2022.

5. How do the results of the 2002 report compare with those of the 2001 report?

The projected account balances are generally not comparable to last year's report because of the significant changes in benefit and financing provisions effected by the Railroad Retirement and Survivors' Improvement Act of 2001. Projected benefit payments are higher as a result of the new law's benefit liberalizations. Tier II taxes are lower in the initial projection years but increase to higher levels under the moderate and pessimistic assumptions due to the automatic tax adjustment mechanism provided by the new law. Expected investment return is higher due to expanded investment opportunities.

6. Did the 2002 report on the railroad retirement system recommend any financing changes?

The report did not recommend any railroad retirement financing changes. The tax adjustment mechanism provided by the new law will, in any case, automatically increase or decrease tax rates in response to changes in fund balance. Even under a pessimistic employment assumption, this mechanism is expected to prevent cash-flow problems for at least 19 years.

7. What were the findings of the 2002 report on the financial condition of the railroad unemployment insurance system?

The Board's 2002 railroad unemployment insurance financial report was also generally favorable. Even as maximum benefit rates increase 50 percent (from $50 to $75) from 2001 to 2012, experience-based contribution rates are expected to keep the unemployment insurance system solvent, except for small, short-term cash-flow problems in 2002 and 2003. However, projections show a quick repayment of the loans even under the most pessimistic assumption.

Unemployment levels are the single most significant factor affecting the financial status of the railroad unemployment insurance system. However, the system's experience rating provisions, which adjust contribution rates for changing benefit levels, and its surcharge trigger for maintaining a minimum balance help to ensure financial stability in the advent of adverse economic conditions.

Under the experience-rating provisions, each employer's contribution rate is determined by the Railroad Retirement Board on the basis of benefit payments made to the railroad's employees. The report predicted that, even under the most pessimistic assumption, the average employer contribution rate remains well below the maximum throughout the projection period.

The report also predicted that the 2.5 percent surcharge that is in effect in calendar year 2002 would remain at 2.5 percent in 2003, and then revert to 1.5 percent in calendar year 2004. A 1.5 percent surcharge is also somewhat likely in 2005.

8. What methods were used to evaluate the financial condition of the railroad unemployment insurance system?

The economic and employment assumptions used in the unemployment insurance report corresponded to those used in the report on the retirement system. Projections were made for various components of income and outgo under each of three employment assumptions, but for the period 2002-2012, rather than a 25-year period.

9. Did the 2002 report on the railroad unemployment insurance system recommend any financing changes to the system?

No financing changes were recommended at this time by the report.

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The Railroad Retirement Board's 2002 financial reports on the retirement and unemployment insurance systems are available in their entirety on the Board's Web site at www.rrb.gov.